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No. 86-1187

Supreme Court, U.S.
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In the Supreme Court of the United States

OCTOBER TERM, 1986

CANISIUS COLLEGE, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether petitioner is entitled to a refund of Federal Insurance Contributions Act (FICA) taxes paid in 1980 on amounts deducted from its employees' salaries and used to purchase tax-sheltered retirement annuities for those employees, on the ground that such amounts are not FICA "wages."

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A45) is reported at 799 F.2d 18. The opinion of the district court (Pet. App. A46-A53) is not yet reported.

JURISDICTION

The judgment of the court of appeals was entered on August 20, 1986. On November 6, 1986, Justice Marshall entered an order extending the time to petition for a writ of certiorari until January 17, 1987,

and the petition was filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner is a nonprofit educational institution exempt from federal income tax under Section 501 (c)(3) of the Internal Revenue Code.[1] During 1980, the taxable year at issue, petitioner operated a voluntary retirement annuity plan for its employees. Employees who chose to participate in this plan agreed to accept a salary reduction in a stated percentage of their compensation. The amounts thus deducted from the employees' salaries, together with additional amounts contributed by petitioner, were used to purchase retirement annuities for the participating workers. Pet. App. A3-A4. Under Section 403(b) of the Code, amounts deducted pursuant to salary reduction agreements from the pay of workers employed by charitable or educational organizations, and used to purchase retirement annuities, are not subject to current federal income tax. Rather, income tax is deferred until such time as the employees actually receive payments under the annuity contracts. See Pet. App. A4. Because of this tax-deferral feature, these arrangements are commonly called "tax-sheltered" retirement annuities. See H.R. Rep. 98-432, 98th Cong., 2d Sess. Pt. II 1658 & n.5 (1984).

Section 3121(a) of the Code defines the term "wages" for purposes of the Federal Insurance Contributions Act (FICA or social security payroll) tax. During the taxable year at issue, "wages" were de-

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[1] Unless otherwise noted, all statutory references are to the Internal Revenue Code (26 U.S.C.), as amended (the Code or I.R.C.).

fined generally to include "all remuneration for employment," but to exclude "the amount of any payment (including any amount paid by an employer for insurance or annuities * * *) *made to, or on behalf* of, an employee * * * on account of * * * retirement" (26 U.S.C. 3121(a)(2)(A)). In 1965, the Internal Revenue Service (IRS) ruled that amounts withheld under salary reduction agreements and used to purchase tax-sheltered retirement annuities were "wages" within the meaning of this definition. Rev. Rul. 65-208, 1965-2 C.B. 383, 385. The IRS reasoned that the words "amount paid by an employer for * * * annuities" as used in Section 3121(a)(2) should be construed to apply only in the situation "where an organization uses its own funds for the purchase of an annuity contract," as distinguished from the situation "where the employee takes a voluntary reduction in salary to provide the necessary funds" (1965-2 C.B. at 384-385). The IRS accordingly concluded that salary reduction amounts were subject to FICA tax, even though those amounts, pursuant to Section 403(b), were not currently includable in the employees' income for income tax purposes (1965-2 C.B. at 384-385).

During 1980, the taxable year at issue, petitioner computed its FICA tax liability consistently with the principles set forth in Rev. Rul. 65-208. Petitioner accordingly treated the amounts withheld from its employees' pay under the salary reduction agreements as "wages" for purposes of Section 3121(a). Petitioner duly paid FICA taxes on the amounts so withheld. Pet. App. A4-A5.

2. In 1981, this Court held in *Rowan Cos.* v. *United States*, 452 U.S. 247, that meals and lodging provided for the convenience of the employer, the value of which was excludable from the recipient em-

ployees' income under Section 119 of the Code, did not constitute "wages" for purposes of FICA tax (452 U.S. at 263). In the course of reaching that decision, the Court reasoned that the term "wages" as used in the Code's FICA provisions should generally be construed "to mean the same thing" (*id.* at 255) that it means in the Code's income-tax withholding provisions, unless Congress has explicitly provided otherwise. For many years prior to the *Rowan* decision, the IRS, as noted above, had taken the position that amounts withheld from employees' pay and used to purchase tax-sheltered retirement annuities did not constitute "wages" for income-tax withholding purposes. See I.R.C. § 3402; Rev. Rul. 65-209, 1965-2 C.B. 414 (amplifying Rev. Rul. 64-333, 1964-2 C.B. 114); Rev. Rul. 65-208, 1965-2 C.B. at 385.

3. In 1983, Congress became aware of the possible implications of the *Rowan* decision upon the proper construction of Section 3121. Congress accordingly amended the statute for the explicit purpose of clarifying the law. Social Security Amendments of 1983, Pub. L. No. 98-21, § 324(a)(2) and (3), 97 Stat. 122-123. This amendment was accomplished by adding to the Code a new Section 3121(a)(5)(E), which defines "wages" for FICA purposes to exclude amounts paid under "an annuity contract described in section 403(b), *other than a payment for the purchase of such contract which is made by reason of a salary reduction agreement*" (Pub. L. No. 98-21, § 324(a)(2)(C), 97 Stat. 122 (emphasis added)).

In addition, while it accepted the narrow holding of *Rowan* concerning meals and lodging allowances, Congress explicitly rejected the Court's broader reasoning that "wages" should generally be construed to mean the same thing for FICA and income-tax with-

holding purposes. Pub. L. No. 98-21, § 327(b)(1), 97 Stat. 127 (now codified at I.R.C. § 3121(a) (penultimate sentence)). This amendment, which is commonly called the *Rowan* "decoupling" provision (Pet. App. A9-A11), was originally made effective for "remuneration paid after December 31, 1983" (Pub. L. No. 98-21, § 327(d)(1), 97 Stat. 127). In 1984, however, Congress amended the effective date of the *Rowan* decoupling provision to ensure that taxpayers did not file refund claims based on the rationale of *Rowan*, *i.e.*, that "wages" for FICA purposes are presumptively the same as "wages" for income-tax withholding purposes. See Pet. App. A18-A22. The 1984 amendment provided that the *Rowan* decoupling provision was to apply to remuneration "paid after March 4, 1983, *and to any such remuneration paid on or before such date which the employer treated as wages when paid.*" Deficit Reduction Act of 1984 (DEFRA), Pub. L. No. 98-369, § 2662(g), 98 Stat. 1160 (amending Pub. L. No. 98-21, § 327(d), 97 Stat. 127) (emphasis added)).

4. Relying on this Court's reasoning in *Rowan*, petitioner filed timely claims for refund of that portion of its 1980 FICA taxes that was attributable to its inclusion of the salary-reduction amounts in its employees' FICA wage base (Pet. App. A8, A47). These administrative claims for refund were denied, and petitioner thereupon brought this refund suit in the United States District Court for the Western District of New York. The district court granted summary judgment for the government, holding that petitioner was not entitled to a refund of FICA taxes for 1980 (Pet. App. A46-A53). The district court agreed with petitioner's contention that Rev. Rul. 65-208 was not a correct interpretation of Section 3121 and

that the amounts withheld by petitioner in 1980 for the purchase of retirement annuities were not at that time FICA "wages" (*id.* at A47-A50). The court held, however, that DEFRA was specifically designed to prevent employers from bringing actions based on *Rowan* to seek refunds of FICA taxes and, further, that it was not unconstitutional to apply that statute to deny petitioner's refund claim (Pet. App. A51-A53).

The court of appeals affirmed on the same grounds (Pet. App. A1-A45). The court found that Rev. Rul. 65-208 was an erroneous reading of Section 3121 and, moreover, was not in accord with this Court's view in *Rowan* that "wages" ordinarily should have the same meaning for FICA and income-tax withholding purposes (Pet. App. A13-A18). The court found, however, that the 1983 and 1984 legislation operated to change the statute in this regard, necessitating the denial of petitioner's refund claim (*id.* at A18-A24). With respect to constitutionality, the court noted that the statute did not abrogate any "vested rights" (*id.* at A26-A29), that it did not upset any "taxpayer reliance" on prior law (*id.* at A30-A31), and that it had a "curative purpose" (*id.* at A33) to prevent the refund of taxes that had been paid pursuant to a well-established Revenue Ruling. Accordingly, the court concluded that the retroactive application of the statute was not so "harsh and oppressive" as to violate due process (*id.* at A24-A36).

ARGUMENT

The courts below correctly rejected petitioner's contention that it is entitled to a refund of its 1980 FICA taxes attributable to amounts deducted from employee salaries to purchase retirement annuities. The arguments raised by petitioner are essentially the same as those that the Court declined to hear last year in *Temple University* v. *United States*, 769 F.2d 126 (3d Cir. 1985), cert. denied, No. 85-1401 (June 16, 1986), and there is no more reason for the Court to grant certiorari now than there was at that time. Indeed, it has become even clearer that this issue does not warrant Supreme Court review. Since last summer, the Second Circuit below and the First Circuit have joined the Third Circuit in rejecting the contentions made by petitioner here. See *New England Baptist Hospital* v. *United States*, 807 F.2d 280 (1st Cir. 1986); see also *Robert Morris College* v. *United States*, 11 Cl. Ct. 546 (1987); *Xavier University* v. *United States*, 633 F. Supp. 15 (S.D. Ohio 1986). The courts of appeals, as well as the district courts and the Claims Court, are thus unanimous in refusing to countenance refund claims of the sort that petitioner filed. Moreover, the questions presented in this case are of diminishing importance because they cannot arise for any taxable year after 1983.

1. Before the constitutional question presented in the petition is even reached, there is the preliminary question whether Rev. Rul. 65-208 was a correct interpretation of the statute in 1980 when the FICA wages at issue here were paid. Although the court of appeals below held that the amounts withheld to purchase annuities were not FICA wages in 1980, we believe that the court erred in this respect. Several

other courts have held, correctly, that such amounts were always FICA wages as specified in Rev. Rul. 65-208. See *Temple University* v. *United States*, 769 F.2d at 129-131 & n.3; *Robert Morris College* v. *United States*, *supra*; *Xavier University* v. *United States*, *supra*; *University Health Center, Inc.* v. *United States*, 622 F. Supp. 88 (D. Vt. 1985).

In Rev. Rul. 65-208, the IRS held that, in determining whether certain amounts would constitute FICA wages, it was appropriate to distinguish between situations in which "an [employer] uses its own funds for the purchase of an annuity contract" and situations in which "the employee takes a voluntary reduction in salary to provide the necessary funds." 1965-2 C.B. at 385. Compare Rev. Rul. 181, 1953-2 C.B. 111 (holding that funds used to purchase retirement annuities are excludable from the FICA wage base when the employer uses its own funds). In thus distinguishing the two situations, the IRS made a reasonable construction of the statute. While all of an employee's compensation emanates from his employer in an ultimate sense, it was appropriate for the IRS, in the case of voluntary salary-reduction agreements, to regard the employee rather than the employer as the *proximate* source of the funds used to purchase the annuities, and hence to conclude that those funds were not "amount[s] paid by [the] employer" within the meaning of Section 3121(a)(2). See *Temple University* v. *United States*, 769 F.2d at 129-130.

The IRS's 1965 construction of the statute is a reasonable one that was consistently followed from 1965 onwards. Congress amended the statute in 1983 in order to codify the IRS's construction, which had not been questioned during the intervening pe-

riod. Indeed, petitioner followed Rev. Rul. 65-208 in making the FICA tax payments that it now seeks to have refunded. The IRS's 1965 ruling, moreover, is consistent with the legislative policy underlying the social security system, which requires that FICA taxes fund extensive social insurance programs. As Congress noted in 1983, if individuals were free to immunize their salaries from FICA tax by entering into voluntary salary-reduction agreements of the sort involved here, they "could, in effect, control which portion of their compensation was to be included in the social security wage base," a result that "would make the system partially elective and would undermine the FICA tax." S. Rep. 98-23, 98th Cong., 1st Sess. 40 (1983).

The conclusion that the IRS's 1965 interpretation of the statute was reasonable is not contrary to *Rowan*. While the broad reasoning of that opinion obviously raises a question about the correctness of Rev. Rul. 65-208, that decision did not directly affect the proper construction of Section 3121(a)(2)(A). The holding of *Rowan* was merely that the value of meals and lodging furnished to employees for the convenience of the employer is excludable from the FICA wage base (452 U.S. at 263). In reaching that holding, the Court relied extensively on legislative history, Treasury Regulations, and IRS rulings concerning the historical tax treatment of employer-furnished "supper money," "room and board," and similar items. See *id.* at 257-262. The Court in *Rowan* was confronted with an inconsistent pattern of administrative construction (see *id.* at 261), not the consistent and unchallenged course of administrative construction that is present here.

Significantly, Congress made clear in passing the 1983 amendment that it "saw Rev. Rul. 65-208 as the properly applicable law" during years prior to 1984 and believed that it was "merely codifying the prior law as articulated in Rev. Rul. 65-208" (*Temple University* v. *United States*, 769 F.2d at 129). As the Senate Report stated (S. Rep. 98-23, *supra*, at 41):

> The bill also provides that any amounts paid by an employer to a tax-sheltered annuity by reason of a salary reduction agreement between the employer and the employee would be includible in the employee's social security wage base. The committee intended that the provision would merely codify the holding of Revenue Ruling 65-208 * * *.

Hence, even without resort to the curative legislation passed by Congress in 1983 and 1984, petitioner's request for refund of 1980 FICA taxes must fail.

2. In any event, the court of appeals correctly held that petitioner's request for a refund was foreclosed by the 1983 and 1984 amendments and that the retroactive application of those amendments was constitutional (Pet. App. A21-A28). This Court has often held that a statute that merely clarifies existing law, as Congress stated that the challenged amendment was designed to do, is not "retroactive" at all in the constitutional sense. *Commissioner* v. *Wheeler*, 324 U.S. 542, 545 (1945); *Commissioner* v. *Fisher*, 327 U.S. 512, 514-515 (1946). Even if those amendments were thought to have changed the law retroactively, this Court has repeatedly upheld the retroactive application of federal tax laws. See, *e.g.*, *United States* v. *Hemme*, No. 84-1944 (June 3, 1986); *United States* v. *Darusmont*, 449 U.S. 292, 296, 297-301 (1981)

(per curiam) (citing cases). In order to prevail on a constitutional challenge, a taxpayer must show that the retroactive application of a particular tax "is so harsh and oppressive as to be a denial of due process." *Id.* at 299. Accord, *e.g.*, *Welch* v. *Henry*, 305 U.S. 134, 147 (1938).

Judged by these standards, petitioner's constitutional argument is plainly insubstantial. The challenged 1984 amendment was a "curative" provision (Pet. App. A33-A34) designed to "avert[] the potentially disruptive effect of the *Rowan* decision on the multitude of transactions properly reported by taxpayers in accordance with the applicable rule of law at the time." *Temple University* v. *United States*, 769 F.2d at 135. Indeed, Congress recognized in 1984 that a decision to *allow* tax refunds of the type sought by petitioner would raise as many retroactivity problems as would a decision to *deny* such refunds. That is because a possible consequence of exclusion of salary-reduction amounts from the FICA wage base would be "reduction of social security benefits being paid to current beneficiaries and recoupment of a portion of benefits which have been paid in recent years on the basis of wage records which included the salary reduction contributions" (H.R. Rep. 98-432, 98th Cong., 2d Sess. Pt. II 1658 (1984)). Congress surely had a "rational legislative purpose" (*Pension Benefit Guaranty Corp.* v. *R.A. Gray & Co.*, 467 U.S. 717, 730 (1984)) in acting to validate a statutory interpretation relied on for 18 years by a multitude of persons, including employers and employees of a wide variety of nonprofit institutions and millions of past, present, and future recipients of social security.

It cannot plausibly be contended that retroactive application of the *Rowan* decoupling provision is "so

harsh and oppressive as to be a denial of due process" (*United States* v. *Darusmont*, 449 U.S. at 299). The 1984 change in effective date imposed no new or unanticipated tax liability upon petitioner. To the contrary, it simply preserved a tax practice that had been universally followed for many years by petitioner and others. In validating that practice, the 1984 amendment did no more than deprive petitioner of the possibility of garnering an undeserved windfall, in the form of potential tax refunds, from an interpretation of the *Rowan* decision that Congress believed to be incorrect. It would have been far more "harsh and oppressive" if the court of appeals had accepted petitioner's invitation to declare the 1984 amendment unconstitutional, thereby jeopardizing the social security benefits of numerous individuals.[2]

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[2] Petitioner also submits (Pet. 29-30) that this Court should grant certiorari here to resolve an alleged "conflict in the circuits regarding the weight to be given to a revenue ruling" (Pet. 29). This submission is mystifying. The court below *rejected* the validity of Rev. Rul. 65-208, and therefore it is apparent that the outcome of this case would remain the same regardless of the correct view of the "weight to be given to a revenue ruling." In any event, there is no basis for petitioner's assertion that such a conflict exists at all. The Third Circuit in *Temple University* found that Rev. Rul. 65-208 was valid because of its examination of the relevant statutory policies and the longstanding acceptance of the statutory construction embodied in the Revenue Ruling by taxpayers and by Congress, not because of any view about the intrinsic weight to be accorded to revenue rulings. The petitioner in *Temple University* alleged a similar "conflict in the circuits regarding the precedential weight of [IRS] revenue rulings" (85-1401 Pet. 12)—in a case where the court of appeals had agreed with Rev. Rul. 65-208 and therefore the deference given to such rulings might conceivably have had some relevance—yet certiorari was denied.

CONCLUSION

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.[3]

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[3] The government recently docketed an appeal in *United States* v. *Crocker Nat'l Bank*, No. 86-1521 (docketed Mar. 19, 1987), which involves a retroactivity question somewhat similar to that here. In that case, as in this one, a question is presented as to the constitutionality of a tax statute designed retroactively to bar tax refund claims based upon an unanticipated judicial decision that Congress viewed as erroneous. We do not believe, however, that it is necessary for the Court to hold this case pending disposition of the government's appeal in *Crocker*. A preliminary question of statutory construction presented in *Crocker* should, we believe, be dispositive of that case. And, as noted above, several courts have already correctly concluded that refund claims like the one presented here must fail because the amounts involved have always constituted FICA "wages" under Section 3121(a)(2) of the Code. Therefore, there is no need to resort to DEFRA to affirm the judgment below, no matter what the resolution of the constitutional issue in *Crocker*, if, indeed, it is reached.

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